

October 6, 2000

Honorable Mayor, City Council and City Manager:

The Comprehensive Annual Financial Report for the City of Tempe, Arizona for the fiscal year ended June 30, 2000, is submitted for your review. Responsibility for the accuracy and completeness of the presented data, including all disclosures, rests with the City. To the best of our knowledge and belief, this report is accurate in all material respects and is presented in a manner designed to fairly set forth the financial position and results of operations of the City. All disclosures necessary to enable the reader to gain an understanding of the City's financial activities have been included.

This report is presented in three sections: 1) the **Introductory Section** which includes this transmittal letter, and the Government Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting; 2) the **Financial Section** which includes the independent auditors' report, the general-purpose financial statements, required supplemental information and the combining and individual fund and account group financial statements and schedules; and 3) the **Statistical Section** which includes selected financial and demographic information, generally presented on a multi-year basis.

This Comprehensive Annual Financial Report represents management's report to its governing body, constituents, legislative and oversight bodies, investors and creditors. Copies of this report will be sent to elected officials, City management personnel, bond rating agencies, Nationally Recognized Municipal Securities Information Repositories, and other agencies which have expressed an interest in Tempe's financial matters. Copies of this financial report will also be placed in the City library for use by the general public.

This report includes all funds and account groups of the City. The City provides a full range of municipal services including police and fire protection, water, sewer and refuse services, development services, municipal courts, recreational activities, streets, transit, traffic control, and general administrative services. In addition to general governmental activities, standards set by the Governmental Accounting Standards Board ("GASB") regarding the inclusion of certain entities based upon the significance of their operational or financial relationships with the City, require that the activities of the Tempe Municipal Property Corporation, Tempe Sports Authority Corporation and the Rio Salado Community Facilities District be included in the reporting entity.

ECONOMIC CONDITION AND OUTLOOK

During the fiscal year, the City's financial position continued to improve through a combination of strong revenue growth and maintenance of sound fiscal policies. Tax revenues increased by 6.5% over FY 98/99 and represents 56.3% of total general governmental fund revenues. Significant growth also occurred in intergovernmental revenue, which increased by 11% and represents 30.6% of total general governmental revenues. General governmental expenditures increased by 11%, largely reflective of the increased provision of public safety and transportation services. The City's policy is to maintain an unreserved, undesignated fund balance in the General Fund at a minimum of 25% of budgeted revenues for the fiscal year. At June 30, 2000, the General Fund unreserved, undesignated fund balance was 31% of budgeted revenues for the year reflecting Tempe's strong financial position.



The Water/Wastewater Fund also continues to do well. Net income (before operating transfers) increased by 25% over the prior year. This is largely reflective of increased commercial and retail development occurring in the growing local economy. The decrease in net income (before operating transfers) in the Refuse and Golf funds are as a result of increased operating costs. Nevertheless, all three funds enjoy strong retained earnings balances at year end.

Tempe is centrally located in one of the fastest growing regions in the country. Long-range forecasts continue to indicate continued economic success and fiscal strength for Tempe. Privilege tax revenues are expected to increase at a rate of 4% over the next year. Intergovernmental revenues are expected to increase at a rate of 9%. Finally, primary and secondary assessed valuations are expected to grow at a rate of 7%. These factors, along with the prudent and conservative financial policies of management, will enable the City to maintain its fiscal soundness.

MAJOR INITIATIVES

For the Year

Several significant events occurred during the fiscal year, which altogether demonstrate the City's commitment to making Tempe the best place to live, work, and play. For the first time in its history, the City officially recognized the right of employees to be represented by labor unions. This was done through an amendment of the City ordinance entitled "Meeting and Confering", which established four employee groups within the City as follows: 1) Fire fighters, all classifications up to and including captain, 2) Police officers, all classifications up to and including sergeant, 3) Non-supervisory employees in the Public Works Department, and 4) All other non-supervisory employees. Each of these groups has the right to union representation for purposes of negotiation with the City on salary, wages, hours, benefits, and working conditions. As of the end of the fiscal year, only the Fire fighters and Police officers groups were officially represented by labor unions.

To further efforts to attract business to Tempe, the City formed the Tech Oasis Partnership along with the Arizona Software and Internet Association and the Arizona Internet Professionals Association. The goal of the partnership is to create a Tech Oasis—a geographic cluster of software/internet companies in and around downtown Tempe. This cluster will be created by aggressively marketing downtown Tempe's attributes to technology companies and by continuously working to improve the business climate of the area. The goal is not only to have new companies locate in the Tech Oasis, but also see existing businesses thrive there.

Plans are being finalized for the first significant development to occur at Tempe Town Lake. Hayden Ferry Lakeside, a massive construction project of upscale condominiums, a hotel, and office buildings next to the lake, is moving closer to breaking ground. The project calls for more than 300 condos, offices and a 258-room Marriott hotel. Hayden Ferry Lakeside will be the first private development along the 2-mile-long waterway. Construction of the \$220 million project is expected to begin by April 2001 and be completed by 2002. It is anticipated that this project will be a catalyst for more development around Tempe Town Lake.

Another impressive development already under construction in the downtown area is The Brickyard on Mill. An overriding goal of the downtown redevelopment effort is the achievement of a mixed use, urban environment. The Brickyard on Mill embodies this philosophy with its true mix of retail, restaurant, office and residential space. This project will occupy nearly a city block and will consist of three separate buildings totaling 641,923 square feet including 800 underground parking spaces. Commercial/retail/office space (a portion of which is owned and will be utilized by the City) will comprise 197,323 square feet of the total, and underground parking will comprise 284,000 square feet. The remaining 160,600 square feet will be allocated across 90 condominiums. The Brickyard on Mill is expected to be completed by Spring 2001. This project, along with Hayden Ferry Lakeside, will further enhance Tempe's tax base.



For the Future

The adequacy of current, public mass transit systems has long been a major issue not only for Tempe, but the entire Phoenix metropolitan area. In a metropolitan area that is experiencing the fastest population growth rate in the country, local governments are focusing on various mass transit alternatives to alleviate the problems of poor air quality, traffic jams, high traffic accident rates, and insufficient freeway construction funding. In 1997, Tempe took a major step towards addressing mass transit with the implementation of a .5% privilege tax increase to fund mass transit. With this increased funding, the City has already implemented expanded bus service. During the fiscal year, the City Council approved Tempe's participation in a regional light rail system. The initial 21-mile segment of this system will run from northwest Phoenix through Tempe and into Mesa and is projected to be completed by 2006. Tempe's portion of this is approximately 5.8 miles.

On May 16, 2000, Tempe voters approved a one-tenth of a percent increase in the privilege tax rate to fund the construction and operation of a performing arts and visual arts center. The new tax, effective January 1, 2001, would generate about \$5 million a year for the proposed \$30 million facility which would house an art gallery, 500-seat theater, 250-seat black box theater and a 125-seat cinema. Childsplay, an arts group who performs primarily for children, the Tempe Chorus, Tempe Symphony Orchestra, and more than 10 other groups would use the center. Construction is expected to begin in fiscal year 2002/03.

FINANCIAL INFORMATION

Internal Control

The management of the City of Tempe is responsible for establishing and maintaining a system of internal control structure designed to ensure that the assets of the City are protected from loss, theft, or misuse and that adequate accounting data are compiled to allow for the preparation of general-purpose financial statements in conformity with generally accepted accounting principles (GAAP). The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived and the valuation of costs and benefits requires estimates and judgments by management.

Budgetary Controls

The City also maintains budgetary controls which are designed to ensure compliance with budgetary and legal provisions embodied in the annually appropriated operating budget approved by the City Council. Activities of the General Fund, Special Revenue Funds (except for Grant and Court Awards), General Obligation and Municipal Property Corporation Debt Service Funds, and Proprietary Funds are included in the annually appropriated operating budget. Project-length budgets are prepared for the Capital Projects Funds. The level of budgetary control (that is, the level at which expenditures cannot legally exceed the appropriated amount) is the total operating budget, as adopted by the City Council. However, for budget administrative purposes, the City maintains budgeting controls at department appropriation levels. In addition to maintaining budgetary control via a formal appropriation, the City maintains an encumbrance accounting system. Encumbrances are made against appropriations upon the issuance of a purchase order. Encumbered appropriations are carried forward at the end of each fiscal year. As demonstrated by the statements and schedules included in the financial section of this report, the City continues to meet its responsibility for sound financial management.

Single Audit

As a recipient of federal and state financial assistance, the City is also responsible for an adequate system of internal control structure to ensure compliance with applicable laws and regulations related to those programs. This internal control structure is subject to periodic evaluation by management and the internal audit staff of the City.



As a part of the City's single audit, performed in accordance with the Single Audit Act of 1996 and the U. S. Office of Management and Budget Circular A-133, tests are made to determine the adequacy of the internal control structure, including that portion related to federal financial assistance programs, as well as to determine that the City has complied with applicable laws and regulations. The results of the City's single audit for the fiscal year ended June 30, 2000, provided no instances of material weaknesses in the internal control structure or significant violations of applicable laws and regulations.

General Governmental Functions

Revenues

Fiscal year 1999/00 general governmental revenue by source is presented, on a generally accepted accounting principles (GAAP) basis, in the following tabulation:

Revenues	1999/00	Percent of Total	Increase (Decrease) From 1998/99	Percent of Increase (Decrease)
Taxes	\$108,451,163	56.3%	\$6,585,818	6.5%
Intergovernmental	59,016,628	30.6%	5,855,463	11.0%
Interest Earnings	8,658,332	4.5%	1,479,822	20.6%
Charges for Services	7,146,295	3.7%	569,601	8.7%
Fines and Forfeitures	5,500,018	2.9%	622,665	12.8%
Licenses and Permits	605,441	0.3%	(494,840)	(45.0%)
Miscellaneous	3,225,687	1.7%	1,069,250	49.6%
	<u>\$192,603,564</u>	<u>100.0%</u>	<u>\$15,687,779</u>	

Revenues for governmental funds (General Fund, Special Revenue Funds and the Debt Service Funds) for the fiscal year ended June 30, 2000, totaled \$192,603,564, a 9% increase from the preceding year.

Taxes include privilege taxes, property taxes (both primary and secondary), franchise taxes, and in-lieu property taxes. Total tax revenue increased by 6.5% over the prior year. This increase is attributable to continuing local sales tax growth and increased primary and secondary assessed valuations.

Intergovernmental revenues increased by 11% over the prior year. This was due to increased state income tax, state sales tax, auto lieu tax and Highway User Revenue Fund collections reflective of the strong local economy. The increase in investment income reflects the availability of higher cash reserves resulting from increased tax, intergovernmental and other revenue collection. The increase in miscellaneous revenue is due to the sale of land.



Expenditures

Fiscal year 1999/00 general governmental expenditures by program is presented on a GAAP basis in the following tabulation:

Expenditures	1999/00	Percent of Total	Increase (Decrease) from 1998/99	Percent of Increase (Decrease)
Current				
Public Safety	\$56,264,882	36.0%	\$7,741,474	16.0%
Environmental Health	737,649	0.5%	(126,449)	(14.6%)
Community Development	17,484,850	11.2%	1,573,025	9.9%
Leisure Opportunities	21,384,329	13.7%	2,259,452	11.8%
Public Transportation	21,179,548	13.5%	5,690,060	36.7%
Policy Management	19,255,707	12.3%	(405,911)	(2.1%)
Debt Service				
Principal	13,985,436	8.9%	(1,139,234)	(7.5%)
Interest and Fiscal Fees	6,121,802	3.9%	(70,969)	(1.1%)
	<u>\$156,414,203</u>	<u>100.0%</u>	<u>\$15,521,448</u>	

Expenditures for governmental funds (the General, Special Revenue, and Debt Service excluding Special Assessments) for the fiscal year totaled \$156,414,203, an 11% increase over the prior year. The increase in public safety is due to increased personnel costs relating to the hiring of several new police officers and merit increases. The increase in community development is due to increased operating costs of the Rio Salado Community Facilities District. The increase in leisure opportunities is due to increased personnel costs mainly relating to merit increases and the conversion of several unbenefited positions to full benefited positions. The increase in public transportation is primarily due to continuing expansion of bus transit services.

General Governmental Fund Balances

Fund balances reflect the excess of revenues over expenditures and other changes in financial reserves. Unencumbered appropriations lapse at the close of the fiscal year and revert back to unreserved/undesignated fund balance. Encumbered amounts are reported as reservations of fund balance. The table below is a summary of general governmental fund balances, presented on GAAP basis, as of June 30, 2000.

Fund Balances	June 30, 2000	June 30, 1999	Increase (Decrease)	Percent of Increase (Decrease)
General Fund:				
Reserved/Designated	\$43,339,743	\$43,363,570	\$(23,827)	(0.1%)
Unreserved/Undesignated	38,615,537	38,201,087	414,450	1.1%
Special Revenue Funds:				
Transit	28,723,037	26,697,759	2,025,278	7.6%
Highway User Revenue	6,586,022	4,956,470	1,629,552	32.9%
Local Transportation Assistance	1,977,951	1,327,274	650,677	49.0%
Rio Salado	1,782,512	5,219,619	(3,437,107)	(65.8%)
Grants and Court Awards	1,098,855	765,667	333,188	43.5%
Community Facilities District	752,250	221,250	531,000	240.0%
General Obligation Debt Service	7,302,028	8,019,429	(717,401)	(8.9%)
	<u>\$130,177,935</u>	<u>\$128,772,125</u>	<u>\$1,405,810</u>	



General governmental fund balances increased by 1% over the prior year. The significant decrease in the Rio Salado Fund is due to increased pay-as-you-go financing of capital projects. The increase in the Transit, Local Transportation Assistance and Highway User Revenue funds reflects increased revenue collections due to the strong local economy. The increase in the Community Facilities District is due to the planned increases in the asset replacement reserve.

Capital Project Funds

The Capital Project Funds account for resources used for the acquisition or construction of major capital facilities other than those financed by Enterprise Funds. Capital improvement expenditures are financed through a combination of bond issuances, pay as you go financing from various revenue sources, fund balances carried forward from 1998/99, and State and Federal grants. During 1999/00, capital improvement expenditures amounted to \$52,184,088. The Capital Projects' fund balance carried forward to the 2000/01 fiscal year in order to complete capital projects amounted to \$55,588,706.

Enterprise Operations

The City's enterprise operations are comprised of three separate and distinct activities — water and wastewater, refuse, and the municipal golf courses. Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to proprietary (private business) enterprises where the intent is that the cost (expenses, including depreciation) of providing goods or services is to be financed or recovered primarily through user charges, or (b) for which periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The following schedule presents, on a GAAP basis, current year income (loss) before operating transfers for the Enterprise funds:

	Income	
	Before Operating Transfers	
	1999/00	Increase (Decrease) from 1998/99
Water and Wastewater	\$12,919,825	\$2,569,942
Refuse	47,919	(481,482)
Golf	172,819	(155,324)

The increase in the Water and Wastewater Fund is due to increased commercial and retail development occurring within the city and the growing local economy. The decrease in the Refuse and Golf funds is principally due to increased personnel costs.

Debt Administration

The City maintained its AA+ rating from Standard and Poor's and its Aa1 from Moody's Investor Service. Tax supported debt is serviced by a combination of secondary property taxes, in-lieu fees, excise and franchise taxes, and Highway User Revenue Funds. Enterprise Fund supported debt is serviced with the user fees associated with the particular fund activity. Special Assessment debt is serviced by assessments levied against property owners within the respective improvement districts.

Under Arizona law, cities can issue general obligation bonds for purposes of water, sewer, artificial light, open space, parks, playground and recreational facilities up to an amount not exceeding 20% of the secondary assessed valuation, and general obligation bonds for all purposes other than those listed up to an amount not exceeding 6% of the secondary assessed valuation.



At June 30, 2000, the 20% debt limitation was \$248,094,360 providing a debt margin of \$160,799,360, and the 6% debt limitation was \$74,428,308 providing a debt margin of \$51,235,000. Total long-term outstanding debt issues (excluding capital improvement notes), at June 30, 2000, were \$198,600,000 as shown in the following table:

Long-Term Outstanding Debt	Balance June 30, 2000
Tax Supported Bonds	
General Obligation	\$66,405,000
Certificates of Participation	4,710,000
Variable Rate Excise Tax Revenue Demand Bonds	40,500,000
Total Tax Supported Bonds	111,615,000
Enterprise Fund Supported	
Water and Wastewater General Obligation	62,600,000
Tempe Municipal Property Corporation (Water)	835,000
Total Enterprise Fund Supported	63,435,000
Subtotal (Tax and Enterprise Supported)	175,050,000
Special Assessment Debt (Improvement Districts)	23,550,000
Total Long-Term Outstanding Debt	\$198,600,000

Cash Management

The City utilizes a pooled cash and investment concept for all funds. Each fund type's portion of the pool is displayed in the general-purpose financial statements as "Pooled cash and investments."

The City's investment policy is to invest pooled cash in a manner which will provide maximum security with the highest investment return while meeting the daily cash flow demands of the City and conforming to all applicable State and City statutes governing the investment of public funds. The City is permitted to invest in obligations of the U.S. Government or any of its agencies and instrumentalities, certificates of deposit, bankers' acceptances, commercial paper, repurchase agreements and the State of Arizona's Local Government Investment Pool. The City's effective annual yield on pooled cash and investments for the 1999/00 fiscal year was 5.79%.

Risk Management

The City of Tempe maintains a protected self-insurance program for its liability (general, automobile, and professional), property, workers' compensation, and group insurance coverages. Liability, property and workers' compensation claims are administered by the Risk Management Division of the Management Services Department, and group insurance claims are administered by the Human Resources Department.

The City maintains an actuarially sound loss fund to pay for claims within its various self-insured retentions (SIR) for each of the above lines of coverage. At June 30, 2000, the loss fund had a fund balance of \$9.4 million. Excess insurance is purchased for claims above the SIRs, thus, making this a protected self-insurance program.

OTHER INFORMATION

Independent Audit

City Charter requires an annual audit by independent certified public accountants. Through a Request for Proposal process, the accounting firm of KPMG LLP has been selected by the City Council. The auditors' report on the general-purpose financial statements is included in the financial section of this report.



In addition to this report, KPMG LLP was also contracted to perform the Single Audit of the City's federal grant programs. This audit was designed to meet the requirements of the Federal Single Audit Act of 1996 and the related Office of Management and Budget Circular A-133. Due to the size and complexity of the City's financial system, the single audit report is issued separately from this financial report. Copies are available upon request.

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada ("GFOA") awarded a Certificate of Achievement for Excellence in Financial Reporting to the City for its comprehensive annual financial report for the fiscal year ended June 30, 1999. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards in the preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, the City published an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. This report satisfied both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The City has received a Certificate of Achievement for the last twenty-four consecutive years (fiscal years 1976-1999). We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA.

The City also received the GFOA's award for Distinguished Budget Presentation for our 1999/00 annual appropriated budget. The City's budget document was judged to be an outstanding policy document, financial plan, operations guide and communications medium. Special recognition was also given for demonstrating exceptional proficiency at integrating capital information into the operating budget.

Acknowledgment

The preparation of this report could not have been accomplished without the dedicated service of the entire staff of the Accounting Division, and the assistance of administrative personnel in the various departments, and the competent service of our independent auditors. To them and to the City Council and City Manager for their support and interest in improving Tempe's fiscal policies and practices, I express my sincere appreciation.

Respectfully submitted,

Rich Oesterle
Financial Services Director